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UNCLAS ZAGREB 001646

SIPDIS

SENSITIVE

TREASURY FOR VIMAL ATUKORALA  
STATE FOR EB/IFD/OMA LIAN VON WANTOCH AND EUR/SCE CARI ENAV

E.O. 12958: N/A

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SUBJECT: EMBASSY COMMENTS ON ICRAS RATING REVEIW FOR CROATIA

Sensitive but Unclassified -- please protect accordingly.

1. (SBU) Embassy Zagreb supports proposal to maintain Croatia's ICRAS rating on sovereign debt at the current C minus, and to increase the non-sovereign risk rating to C minus.

2. (SBU) While the fiscal and current account deficits warrant close monitoring, and the failure of Croatia to complete its last Stand-by Arrangement must be recognized, we agree with the drafters of the Country Risk Assessment Report that Croatia is at a different place economically and politically than it was in 2001, when the ICRAS ratings were last determined.

3. (SBU) We would stress the following factors:

-- The banking sector has been revamped since the beginning of the decade, and is one of the most open and sophisticated in the region. Central Bank measures to slow the inflow of money to the banks -- flows that have fueled an import boom -- appear to be working.

-- The worst of the fiscal deficits (2003) and current account deficits (2002) appear to be behind us, and should the government keep close to its announced targets, the twin deficits should be under control. (The ability of the new government to keep to its ambitious budget targets remains untested. Should Croatia be unable to keep the current SBA on-track, the ratings might need to be revisited.)

-- The beginning of EU negotiations early next year and the desire of the government to close the gap between its accession track and those of Romania and Bulgaria will provide a powerful incentive for the GOC to ratchet down the deficits. The EU has been a very effective proponent of Croatia keeping within an IMF program and the fiscal discipline that encourages -- it was key in causing the new government to pursue a new agreement.

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